

Message Text

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TAGS: OECD, ECON
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC); MARCH 15 REVIEW OF SWEDEN

REF: (A) PARIS 8589; (B) STATE 6564;
(C) STOCKHOLM 986

1. SUMMARY: SWEDISH DELEGATION (LED BY WOHLIN OF
ECONOMIC AFFAIRS) OPINED THAT SWEDEN COULD ONLY TAKE
PASSIVE ROLE IN "CONCERTED ACTION" STRATEGY FOR TIME
BEING SINCE IT WAS NOW OVER-EXTENDED BY ATTEMPTS AT
"BRIDGING POLICIES" DURING 1975/76. SWEDEN MUST NOW
CONCENTRATE ON RESTORING COMPETITIVE POSITION AND EFFECT-
ING NECESSARY STRUCTURAL CHANGES -- WHILE RESTRICTING
OPEN UNEMPLOYMENT TO CURRENT LEVELS. LOW NOMINAL LABOR
COST INCREASES (PERHAPS ALONG LINES OF RECENT CONTRACT)
AGREED TO BE ESSENTIAL TO RESTORE EQUILIBRIUM. SWEDISH
DEL REJECTED SECRETARIAT'S SUGGESTION THAT 1978 FISCAL
POLICY MAY HARM FIGHT AGAINST INFLATION BY PROVIDING
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TOO MUCH LIQUIDITY. SECRETARIAT AND EDRC RELUCTANT TO
ENDORSE MASSIVE SWEDISH SECTORAL AND EMPLOYMENT SUBSI-
DIES, BUT AGREED THAT PROGRESS WAS BEING MADE ON STRUC-
TURAL ADJUSTMENT. PARTICIPATION OF E/C OFFICER BUTCHER
WAS VALUABLE ADDITION TO U.S. DELEGATION TO SWEDISH
REVIEW. END SUMMARY

2. ECONOMIC SETTING: SWEDISH DELEGATION DID NOT STRONGLY DIFFER WITH THE FACTS OF THE ECONOMIC SCENE AS PRESENTED BY THE SECRETARIAT. SWEDES SUGGESTED, HOWEVER, THAT SWEDEN'S PRESENT POLICY STRATEGY MUST BE SEEN IN THE APPROPRIATE FRAMEWORK, NAMELY, IN THE LONGER-TERM PERIOD WHICH WILL BE REQUIRED TO RECOVER INTERNAL AND EXTERNAL EQUILIBRIUM FROM WHICH THE ECONOMY HAD SERIOUSLY STRAYED IN 75/76. WHEN SUCH A MAJOR DEVIATION FROM EQUILIBRIUM TAKES PLACE, POLICY CANNOT BE EXPECTED TO RESTORE IT QUICKLY, BUT MUST DO SO IN STAGES AND GRADUALLY, AT A SPEED AND IN A MANNER WHICH IS SOCIALLY ACCEPTABLE. IN THIS LIGHT, 1977 WAS, ACCORDING TO THE SWEDISH DELEGATION, A YEAR OF CONSOLIDATION, THE FIRST PHASE, DURING WHICH (A) INTERNATIONAL COMPETITIVENESS WAS RESTORED BY A MAJOR DEVALUATION (RELATIVE UNIT LABOR COSTS WERE LOWERED); (B) THE STRONG UPWARD TREND IN CONSUMPTION WAS BROKEN (WHICH ALSO HELPED SLOW IMPORTS); AND, (C) UNDERSTANDING OF THE SERIOUSNESS OF THE SITUATION WAS BUILT TO PROVIDE BASIS FOR SLOWING NOMINAL WAGE INCREASES (DECELERATING FROM 20 PERCENT INCREASE IN 1976 TO 10 PERCENT IN 1977). DURING 1977 INVENTORIES FELL STRONGLY, AS THE SCHEMES TO ENCOURAGE STOCKBUILDING WERE PHASED OUT -- THUS REDUCING 1977 GDP BUT CONTRIBUTING TO THE BASIS FOR EVENTUAL RECOVERY OF PRODUCTION. THE SECOND PHASE, IN 1978, WILL SEE CONTINUED POLICY PRESSURE TO REDUCE NOMINAL WAGES (RECENT CONTRACT CALLS LIMITED OFFICIAL USE

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FOR 5 PERCENT NEGOTIATED INCREASE OVER 21 MONTHS), EXPANDED EXPORTS EQUAL TO WORLD MARKET GROWTH (AS MARKET SHARES ARE MARGINALLY REGAINED), REDUCED IMPORTS IN REAL TERMS (ALTHOUGH J-CURVE EFFECTS WILL MITIGATE FAVORABLE INFLUENCE ON CURRENT ACCOUNT), AND SLOWER INVENTORY DECUMULATION WITH LESS REPRESSIVE EFFECT ON THE ECONOMY. SWEDISH DEL REPORTED THAT INVESTMENT OUTLOOK WAS ALSO BETTER THAN HAD BEEN EXPECTED, DUE IN PART TO RESOURCE SHIFTS TO OPEN SECTOR. BY THE THIRD PHASE, HOPEFULLY 1979/80 CAPACITY UTILIZATION WILL HAVE RETURNED TO NORMAL LEVELS, STIMULATING PRIVATE INVESTMENT -- AT THE SAME TIME, DEMAND RECOVERY WILL DRAW ON THE "PRODUCTIVITY RESERVE" ACCUMULATED DURING RECESSION (ESTIMATED AT 12-15 PERCENT OF POTENTIAL OUTPUT), ENHANCING THE COMPETITIVE POSITION.

3. SWEDISH INDUSTRIAL POLICY IS PART OF THIS LONGER-TERM STRATEGY AND IS DESIGNED TO PREVENT UNNECESSARY

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LOSS OF CAPACITY DURING THE LONG RECOVERY. INDUSTRIAL SUPPORT CANNOT, ACCORDING TO SWEDISH DEL, BE ALLOWED TO BECOME PERMANENT OR IT WILL PREVENT ADJUSTMENT, BUT AT THE SAME TIME IT MUST BE WIDESPREAD SINCE IT IS SO DIFFICULT TO JUDGE WHICH PART OF CAPACITY WILL BE COMPETITIVE WHEN EQUILIBRIUM IS RESTORED. SWEDISH DEL NOTED, HOWEVER, THAT SECTORAL SUPPORT SCHEMES DID REQUIRE CAPACITY REDUCTIONS IN THOSE SECTORS WHICH ALREADY HOLD LITTLE CHANCE OF BECOMING COMPETITIVE. HE AGREED THAT SECTORAL SCHEMES DIRECTLY BENEFIT DECLINING INDUSTRIES, BUT ADDED THAT GENERAL POLICIES BENEFIT RISING INDUSTRIES TO GREATER EXTENT. PHASING OUT OF SECTORAL POLICY WOULD BE PHASE 4 OF THE RETURN TO EQUILIBRIUM.

4. EMPLOYMENT POLICY WAS PRESENTED IN SIMILAR VEIN AS MEANS TO KEEP WORKERS IN PRIVATE SECTOR EMPLOYMENT AND, WITH INCREASED TRAINING, READY TO RESUME HIGHER PRODUCTION LEVELS WHEN NEEDED. SWEDISH DEL ACKNOWLEDGED POSSIBLE LINKS BETWEEN INDUSTRIAL/EMPLOYMENT POLICIES AND PROTECTIONIST MEASURES TAKEN BY OTHERS -- BUT ANSWERED
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THAT SUBSIDIES WERE TEMPORARY, WITH EVERY ATTEMPT BEING

MADE TO AVOID IMPACT ON INTERNATIONAL PRICES. IF OPEN UNEMPLOYMENT WERE HIGHER, GOVERNMENT WOULD, ACCORDING TO SWEDISH DELEGATION, BE FORCED TO FOLLOW MORE EXPANSIONARY MACRO POLICY AT GREATER COST IN INFLATION AND COMPETITIVENESS. SECRETARIAT POINTED TO DANGER THAT SYSTEM WOULD BECOME RIGID AS RESULT OF EXTENSIVE INDUSTRIAL AND EMPLOYMENT SCHEMES, BUT AGREED THAT SWEDEN SEEMED TO BE DOING REMARKABLY WELL IN BRINGING OFF ADJUSTMENT DESPITE THE MEASURES.

5. WAGES, PRICES AND PROFITS: SWEDES INDICATED THAT RECENT WAGE CONTRACT, PLUS FIFTH WEEK VACATION, WAGE DRIFT AND CARRYOVER, WILL RESULT IN ESTIMATED 9 PERCENT NOMINAL WAGE INCREASE DURING 1978, FALLING TO PERHAPS 5 PERCENT IN 1979. SECRETARIAT NOTED THIS WOULD BE AMONG BEST RECORD IN OECD DESPITE LOW OPEN UNEMPLOYMENT IN SWEDEN. WAGE PERFORMANCE, HOWEVER, DEPENDS TO SOME EXTENT ON RESTRAINING INFLATION SINCE CONTRACT WAGE INCREASES SUBJECT TO RENEGOTIATION IF CPI RISES MORE THAN 7.25 PERCENT OVER 11 MONTHS, FEBRUARY TO DECEMBER, 1978. SWEDISH DEL STATED THAT GOVERNMENT WAS COMMITTED TO KEEPING INFLATION BELOW THE TRIGGER RATE AND HAD THE NECESSARY TOOLS TO DO SO. IF INFLATION AND WAGE FORECASTS ARE MET, THEN ENTIRE PRODUCTIVITY INCREASE (FORECAST 5 PERCENT) WOULD GO INTO PROFIT RECOVERY. SWEDISH DELEGATION BELIEVES THAT THIS IS INITIAL STAGE OF TREND TO HIGHER PROFIT WHICH HAD BACKING OF ALL LABOR MARKET PARTNERS -- AND WHICH COULD LEAD TO "ABOVE NORMAL" PROFITS FOR SOME PERIOD OF TIME GIVEN THE NECESSITY TO AMORTIZE DEBT. HOWEVER, SWEDISH DEL FELT THAT LOW PROFIT SITUATION WAS SOMEWHAT EXAGGERATED -- AS LOSSES BY WORSE 10 PERCENT OF FIRMS MASKED PROFITS ACCRUING TO LIMITED OFFICIAL USE

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OTHERS.

6. ECONOMIC POLICY: SWEDISH DELEGATION REJECTED SECRETARIAT'S CONTENTION THAT EXPANSIVENESS OF TOTAL GOVERNMENT SECTOR IN 1978 WOULD ENDANGER MONETARY POLICY OBJECTIVES, ENGENDER INFLATION. DEL STRESSED THAT CENTRAL GOVERNMENT BUDGET SHOWED ZERO REAL INCREASE IN EXPENDITURES FOR GOODS AND SERVICES -- AND THAT LOCAL GOVERNMENT SPENDING, SUBJECT TO LONG LAGS, WAS RESULT OF PROGRAM AGREED TO IN 1974/75 PERIOD AND WOULD ALSO SLOW CONSIDERABLY IN FUTURE AS FINANCIAL RESOURCES ARE TIGHTENED. CENTRAL BANK REP AGREED THAT LARGE BUDGET DEFICITS WERE POTENTIALLY DANGEROUS IF PERSISTENT OVER LONG TERM, BUT FELT THAT M3 INCREASE OF 15 PERCENT IN 1978 WOULD, GIVEN SLACK IN ECONOMY, BE HARMLESS. HE ADDED THAT SWEDEN HAS PURSUED TIGHT LIQUIDITY POLICY

SINCE 1974 AND ECONOMY CAN EASILY ABSORB SPURT IN 1978.
SWEDEN'S TRADITIONAL CREDIT RATIONING APPROACH TO MONE-
TARY POLICY IS CLEARLY PRINCIPAL FACTOR IN NEUTRALIZING
POSSIBLE EXCESS LIQUIDITY, BUT ADDITIONAL MEASURES TO
SOAK UP HOUSEHOLD LIQUIDITY IN LONG-TERM ASSETS AND
THROUGH PAYROLL SAVINGS SCHEMES ARE IN PLACE OR PROPOSED.

7. ON EXTERNAL POLICY, BOTH SWEDISH DEL AND SECRETARIAT
CHARACTERIZED 1977 DEVALUATION AS A SUCCESS SINCE IT
RESULTED IN IMPROVED RELATIVE UNIT LABOR COST, SWITCHED
REVENUES TO OPEN SECTOR, AND STIMULATED REAL EXPORTS AS

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MEASURED BY EXPORT ORDERS. CURRENT ACCOUNT WILL NOT
IMPROVE IMMEDIATELY DUE TO TERMS OF TRADE EFFECTS, BUT
SWEDISH AUTHORITIES ARE CONFIDENT THAT AT MINIMUM TREND
IN TRADE ACCOUNT WILL BE POSITIVE. INVISIBLES, PARTICU-
LARLY TOURISM AND SHIPPING, ARE NOT SO PROMISING. A TAX
ON CHARTER FLIGHTS WILL, HOWEVER, HELP TO IMPROVE RELA-
TIVE HOME PRICES FOR TOURISTS AND WILL PARTIALLY OFFSET
THE LACK OF A VAT ON CONSUMER EXPENDITURES ON TOURISM.
SWEDISH AUTHORITIES ARE NOT TOO CONCERNED ABOUT ACCUMU-
LATED EXTERNAL DEBT SINCE PRINCIPAL WOULD NORMALLY
BE ROLLED-OVER AND INTEREST WAS LITTLE MORE THAN OFFSET
FOR INFLATION.

8. OVER MEDIUM TERM, GOS RETAINS GOAL OF RESTORING EXTERNAL AND INTERNAL EQUILIBRIUM -- BUT PREFERS NOT TO BE TIED TO SPECIFIC DATE, ESPECIALLY FOR EXTERNAL SIDE. SWEDISH DELEGATION SAW SOME LONGER-TERM PROBLEMS IF PRESENT LEVELS OF GOVERNMENT AND CURRENT ACCOUNT DEFICIT CONTINUED, BUT DID NOT BELIEVE THAT WOULD OCCUR -- PRINCIPALLY DUE TO CURRENT FAVORABLE TRENDS IN COMPETITIVE LIMITED OFFICIAL USE

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POSITION, LONGER-TERM RESTRICTIVENESS OF GOVERNMENT POLICY, AND EVENTUAL EFFECT OF "PRODUCTIVITY RESERVES." ACCORDING TO GOS ESTIMATES, TO ACHIEVE DESIRED RESULT, CONSUMPTION, PUBLIC AND PRIVATE COMBINED, CAN GROW AT MOST 2 PERCENT PER ANNUM AND EXPORTS MUST GROW 2 TO 4 PERCENT FASTER THAN GDP. OBVIOUSLY, SUCH A SCENARIO WILL REQUIRE A RECOVERY IN WORLD TRADE IN ADDITION TO HIGHER MARKET SHARES FOR SWEDEN.

8. CONCLUSIONS: EDRC CONCLUDED THAT SWEDEN HAS MANAGED MUCH BETTER IN 1977 THAN HAD BEEN EXPECTED AT TIME OF LAST REVIEW -- AND THAT THE OUTLOOK FOR THE FUTURE WAS THEREFORE STRONGER. COMMITTEE AGREED THAT DEGREE OF DIVERGENCE FROM EQUILIBRIUM WOULD REQUIRE LONG-TERM SOLUTION -- BUT WAS CONCERNED THAT RIGIDITIES BEING BUILT-IN BY SECTORAL AND EMPLOYMENT POLICY MAY PLACE DIFFICULT HURDLES IN THE WAY OF LONG-TERM ADJUSTMENT. INFLATION IS A KEY DANGER -- AND THE COMMITTEE WAS HEARTENED BY THE EVIDENT PROGRESS IN OBTAINING THE CONSENSUS NECESSARY TO SLOW WAGE COSTS -- BUT URGED CONTINUED CAUTION SO THAT COMPETITIVE GAINS FROM THE DEVALUATION NOT BE LOST THROUGH CREEPING WAGE AND PRICE INCREASES. EDRC CHAIRMAN CONCLUDED THAT HOPE WAS A PRINCIPAL ELEMENT IN SWEDISH OUTLOOK. SALZMAN

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